

The ageing population and pensions: will we cope?

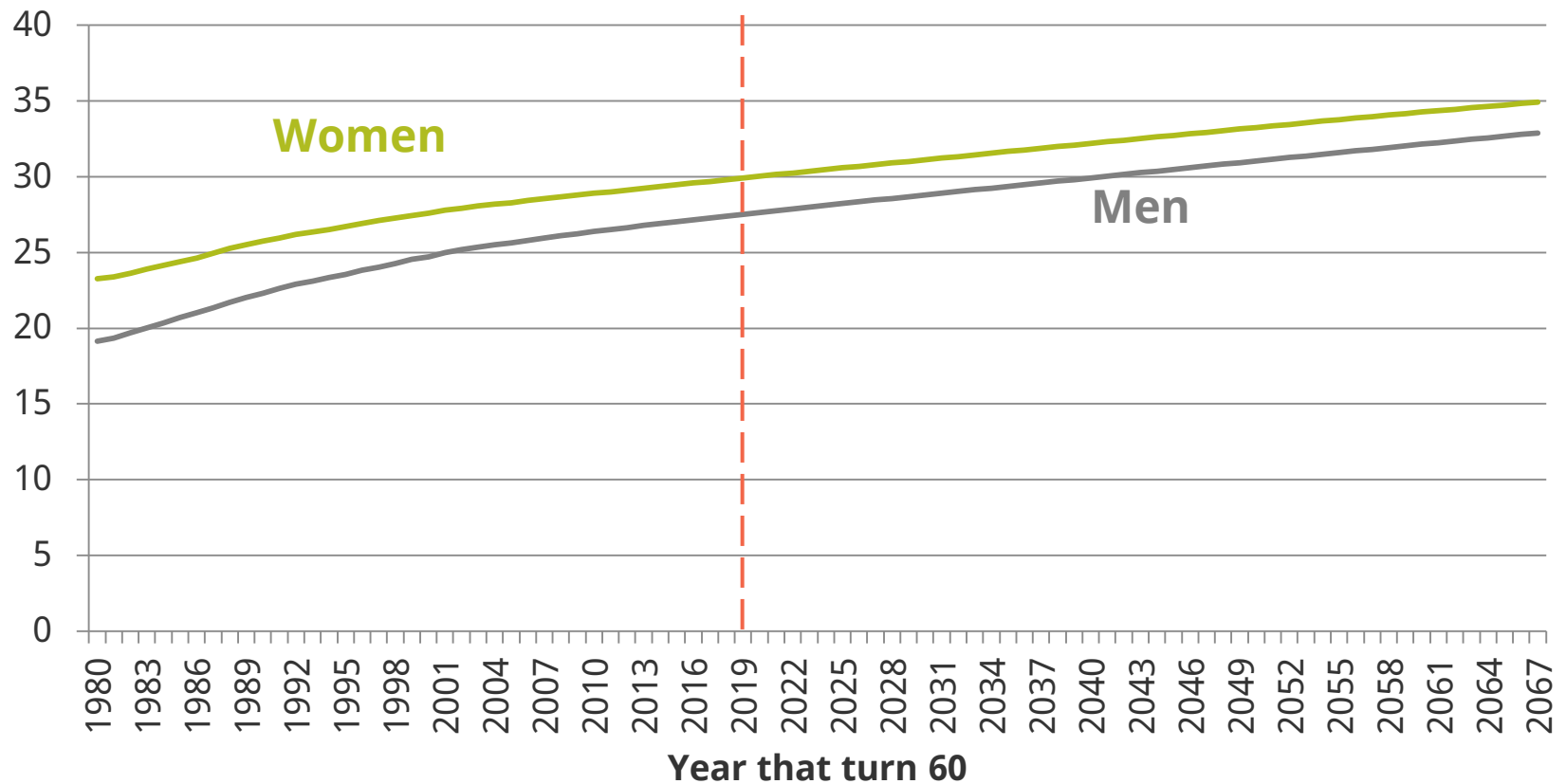
ESRC Festival of Social Science

David Sturrock

November 2019

The UK's ageing population

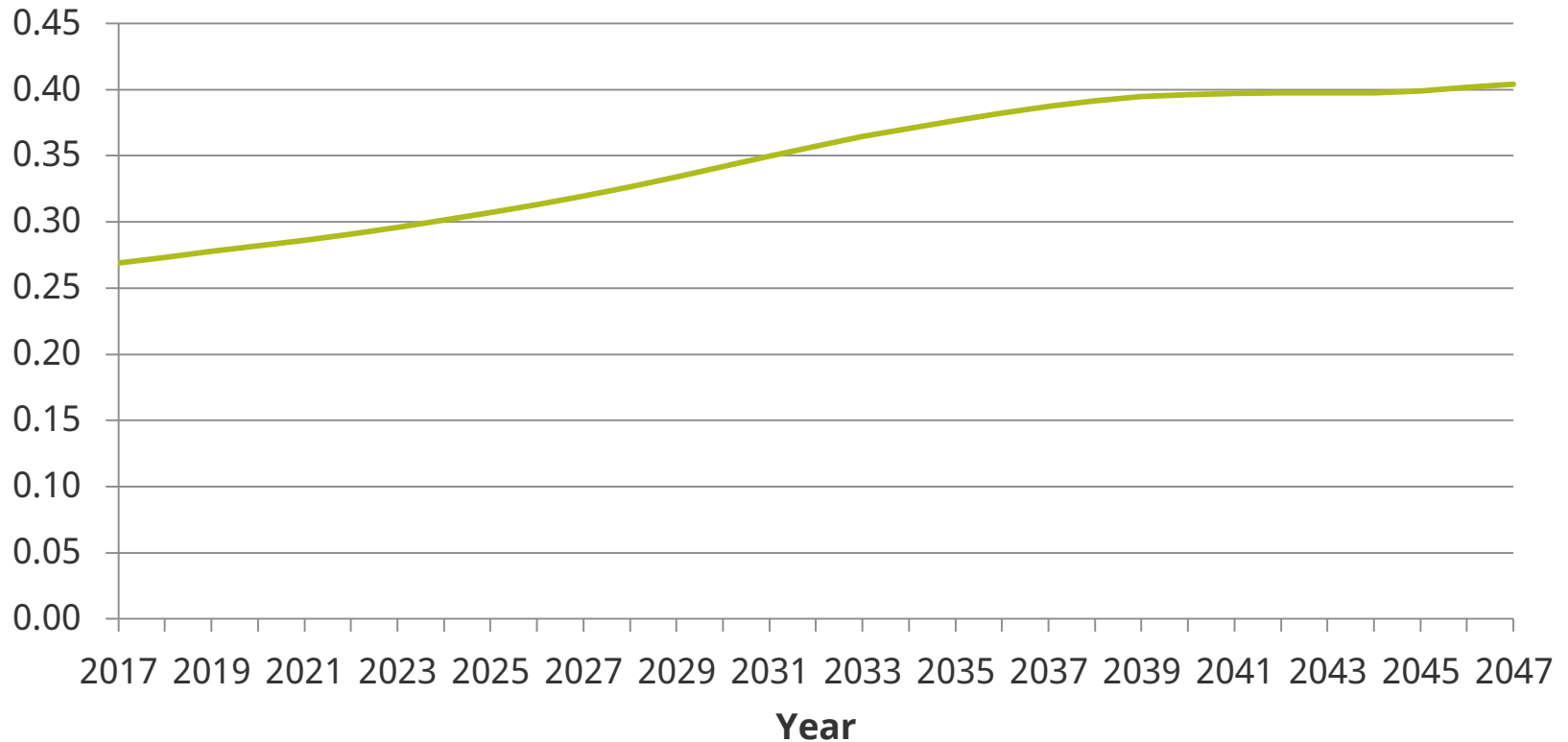
Life expectancy at 60



Source: ONS

The UK's ageing population

Projected old-age dependency ratio



Note: Old age dependency ratio is calculated as the total projected population aged 65 and above divided by the total projected population aged 16-65.

Source: ONS

World government? For the first time in my life, I think the formation of such a thing is plausible Gideon Rachman Page 13

Pensions lifeboat risks being swamped Ross inquiry launched as ex rocks Carphor

The Telegraph Money | Pensions

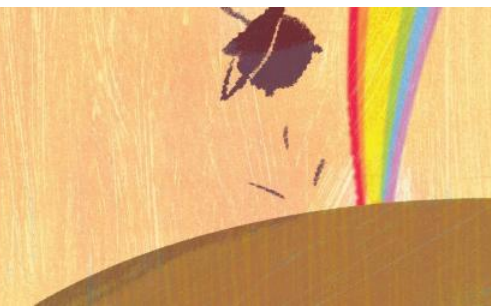
Home > Money > Pensions > News

The £1 trillion pension crisis facing 11m (and they're the lucky ones)

Share icons for Facebook (8), Twitter (18), and Email (16)



UK should axe state pension for rich people, says OECD



Pension deficit of UK's leading companies equivalent to 70% of their profits

UK's leading plcs have combined deficit of £6.2bn, with the percentage of their profits higher than in 2009 after financial crisis



Deliciously simple dishes that can help save your life

PENSION BLOW FOR 1.5 MILLION

Stealth tax raid set to punish middle-aged savers

Article snippet: Ruth Lythe Money Mail Reporter P to 1.5million workers facing hit by a stealth tax raid on their pensions.

News > Business > Business News

UK retirement age could hit 80 as pensions deficit sets off time bomb

World Economic Forum points to shortfall of trillions in what people are saving against the cost of funding their retirement

Elton: Why my boys won't inherit my £200m fortune



PENSIONS BOMBHELL

NOW IT'S WORK TO 75

Osborne poised to raise age again Experts warn of long wait for payout

The prospect of people marking time until 75, as raised by a review of the state pension age, makes it a bit of a second look page. Your 75 is 75, predicts the Daily Mirror



Katie: I may have aborted Harvey if I had known about his disability

NOW 10p

SO WHAT NEXT FOR TV CHEF JAMES MARTIN

WOULD YOUR HEART PASS AN MOT?

PENSION CRISIS FOR MILLIONS

Fears of poverty in old age mean many will NEVER retire



Now for the big clean-up... Storm Katie's trail of destruction

5p DAILY EXPRESS

FREE INSIDE HAPPINESS DIET Kickstart the New Year with our lose weight and feel great plan

FREE SLIMFAST SHAKE FOR EVERY READER

PENSIONS CRISIS TO LAST FOR 20 YEARS

Europe's threat to UK over refugees BRUSSELS is threatened unless an asylum free-which could turn Britain into more of a magnet for refugees emerged last night. Eurocrats plan to rip up



Dapper Duke: Why Prince Philip is our most stylish Royal

How will we cope? Is it really all that bad?

Big changes are taking place. These raise questions:

1. What does ageing mean for the sustainability of pensions systems?
 2. How should the government respond?
 3. Are people able to going to be able to provide for their retirement?
- Using UK data, but lessons apply in many advanced economies

Pensions and the challenge of demographics

Pensions in the UK: a primer

1. State pension

- Paid at a **fixed rate** to everyone with sufficient years of eligible activities (currently £160/week)
- Paid out of **current** taxation (“Pay as you go”)

2. Employer provided pension

- Defined benefit - pays an amount that depends on earnings in working life according to some rule
- Defined contribution: employee decides how much to contribute into a pension ‘pot’. In retirement, choose how to spend this pot.

3. Other forms of saving

- House, holdings of stocks and shares, personal pensions etc.

Population ageing and the state pension

Increasing longevity makes “pay-as-you-go” systems less affordable

- Same number working, supporting more pensioners for longer

For the state pension system, this requires one or more of:

1. Increase in taxation for those working
2. Reduction in generosity of state pensions:
 - Pension paid at a lower rate
 - Increase in the state pension age
3. Government borrowing (i.e. higher taxes or lower spending later)

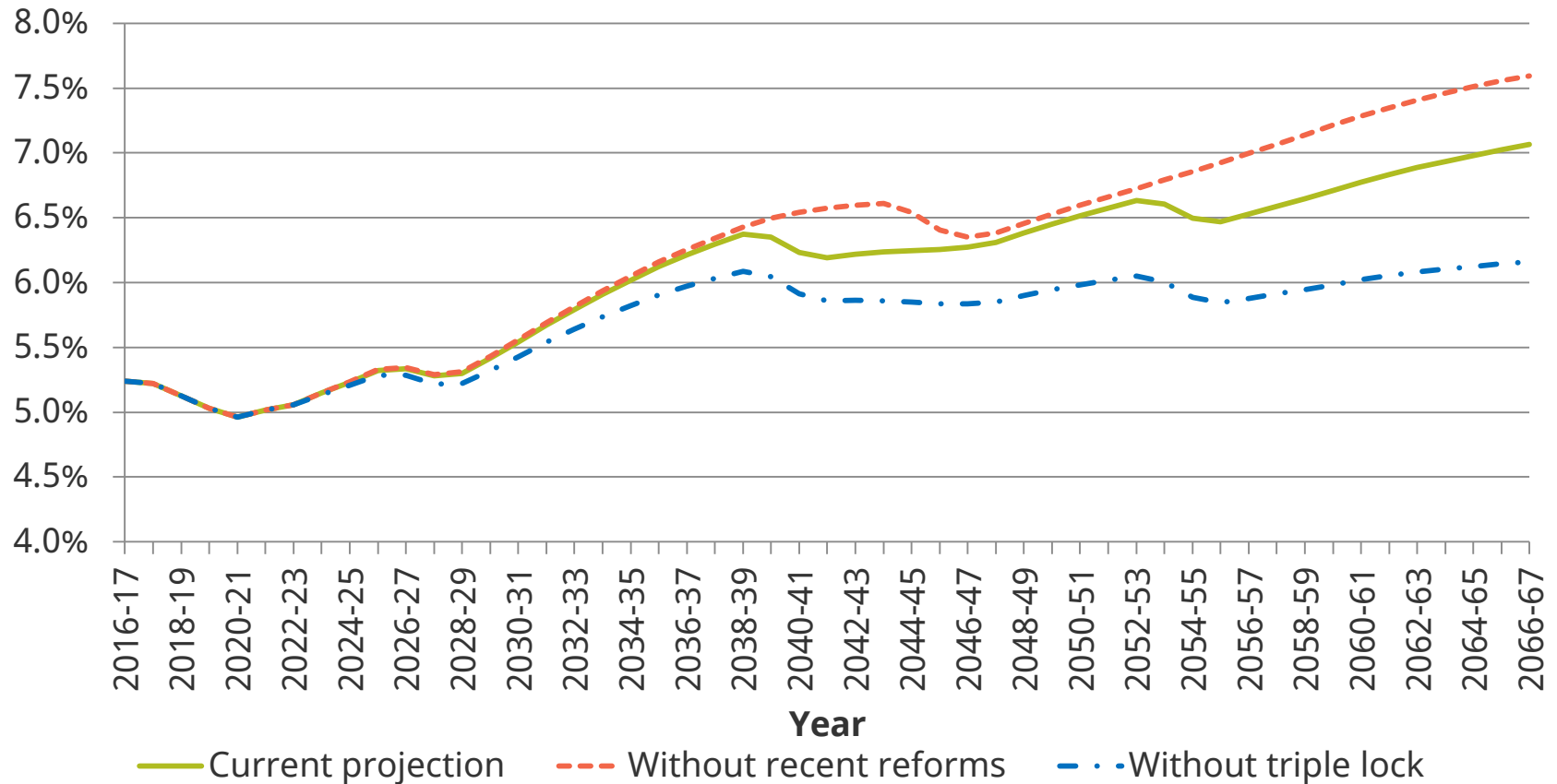
Population ageing and the state pension

Government has responded by reducing generosity of pensions:

- Elimination of earnings-related components of the state pension
- State pension age (SPA) increasing:
 - Was 65, now rising
 - Will reach 68 by 2039
 - Next review considering further rises will report by 2023

Population ageing and the state pension

Projected state pension spending as a percentage of GDP



Source: OBR Fiscal Sustainability Report

Population ageing and employer pensions

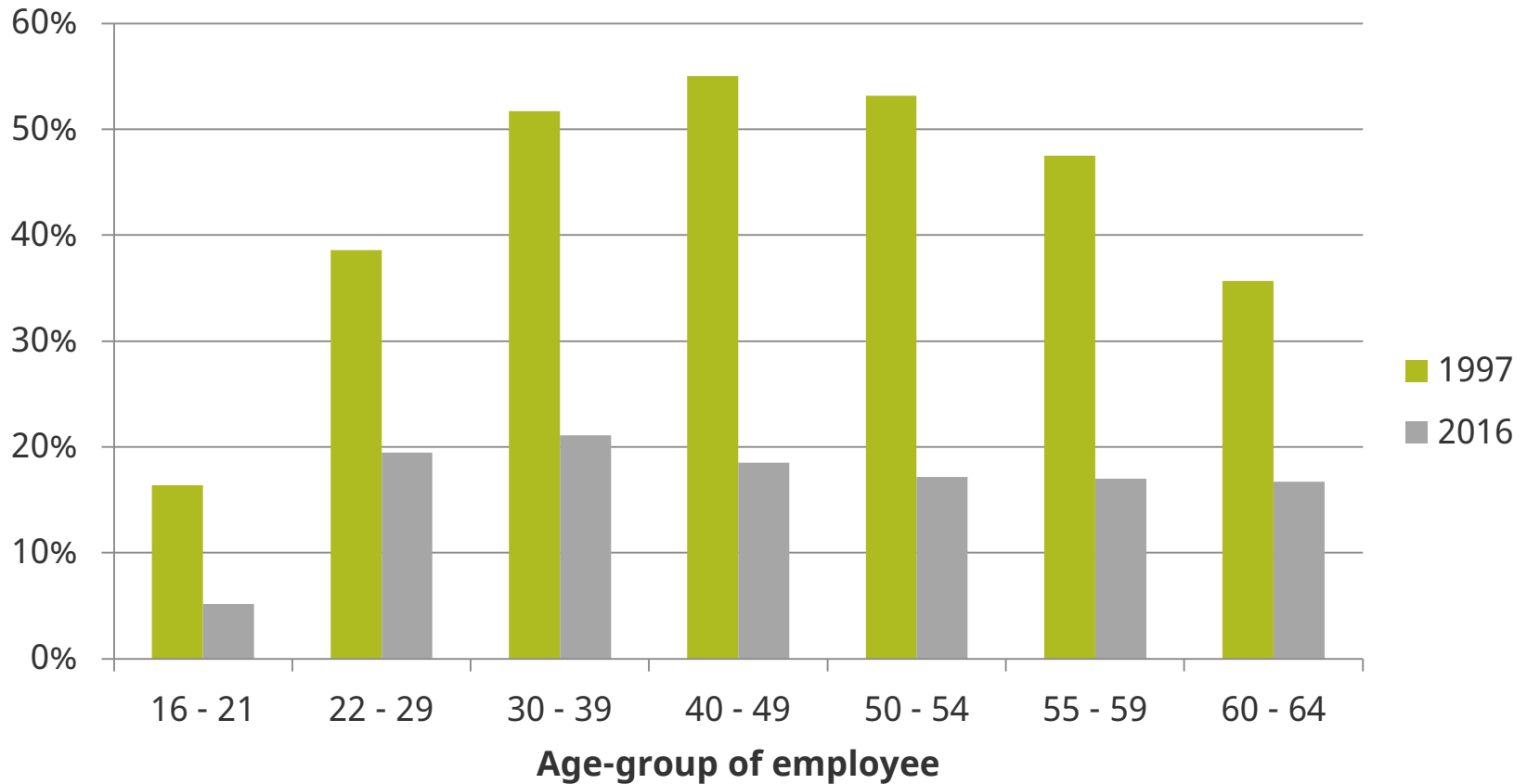
Increased longevity and low interest rates have also put pressure on defined benefit pension schemes

- Many have struggled financially

Employers withdrawing from offering DB pensions

Population ageing and employer pensions

Percentage of employee jobs in a defined benefit pension scheme



Source: ONS

How do individuals provide for their retirement?

Are we ready?

Providing for retirement is increasingly an individual responsibility

- State pension worth around a third of full-time earnings
- Defined contribution pensions now the norm

If people were completely rational, all-knowing, all-calculating, we might see few problems

- Individuals choose what is best for them: trade-off spending vs saving

But economics tells us the world is not like that – in important ways!

1. 'Irrationality': impatience and procrastination about saving
2. Imperfect information: underestimating survival chances

Impatience and procrastination

Individuals tend to give extra “weight” to today when making decisions – **“present bias”**

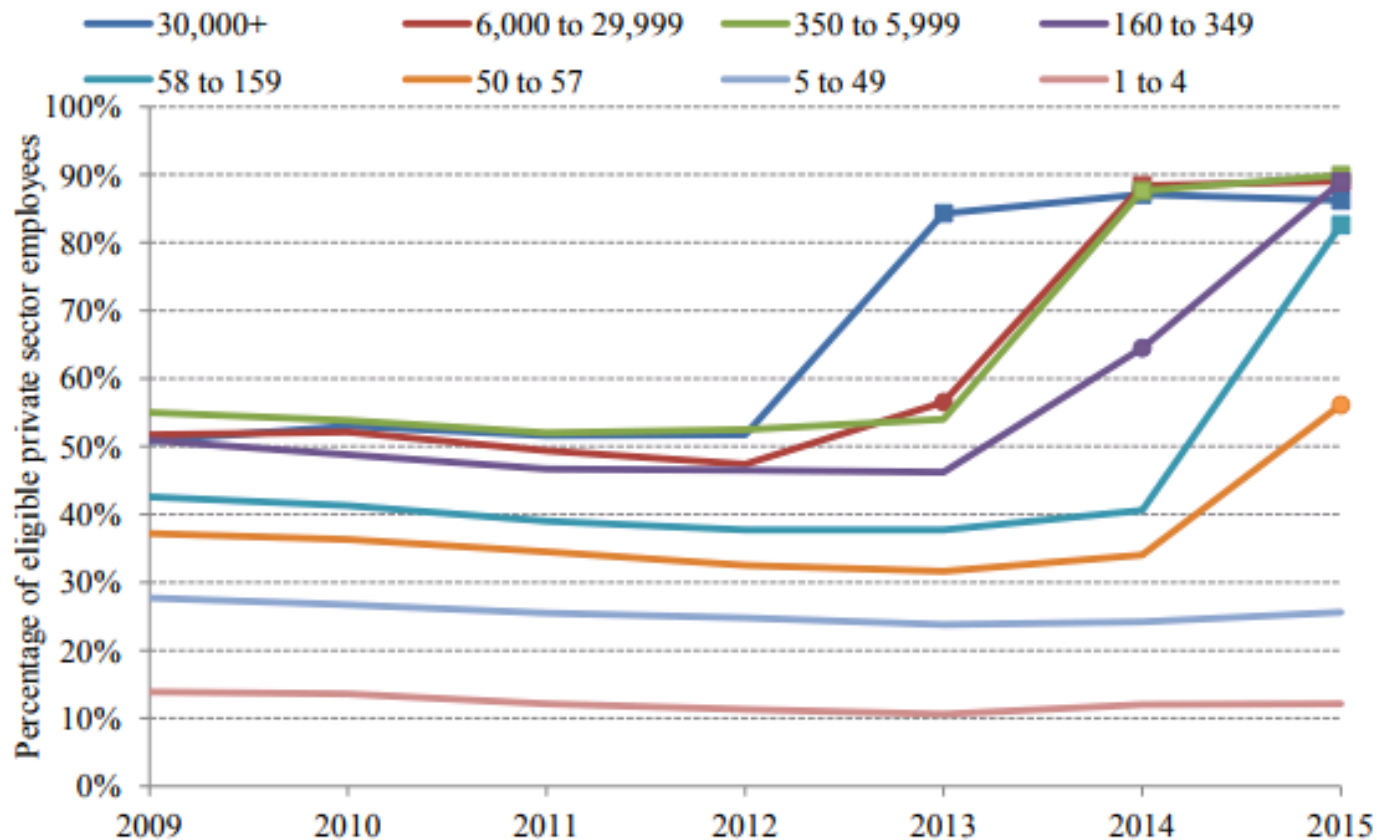
- People also often tend to stick with the default option: **“inertia”**
- This can lead people to put off savings decisions

Policy response has been to **automatically enrol** workers into workplace pension scheme

- US “Save for Tomorrow” schemes (Thaler and Benartzi, 2004)
- In UK, Pensions Act (2005):
 - Default contribution rate of 8% (at least for 3% from employer)
 - Individuals can still choose to leave scheme if they wish

Impatience and procrastination: policy

Workplace pension membership rates amongst private sector employees eligible for automatic enrolment by firm size in 2012



Impatience and procrastination

Individuals tend to give extra “weight” to today when making decisions –
“**present bias**”

Policy response has been to **automatically enrol** workers into workplace pension scheme

Workplace pension **participation rates have risen dramatically**

- Are the right people opting out?
- Should contribution rates rise further?

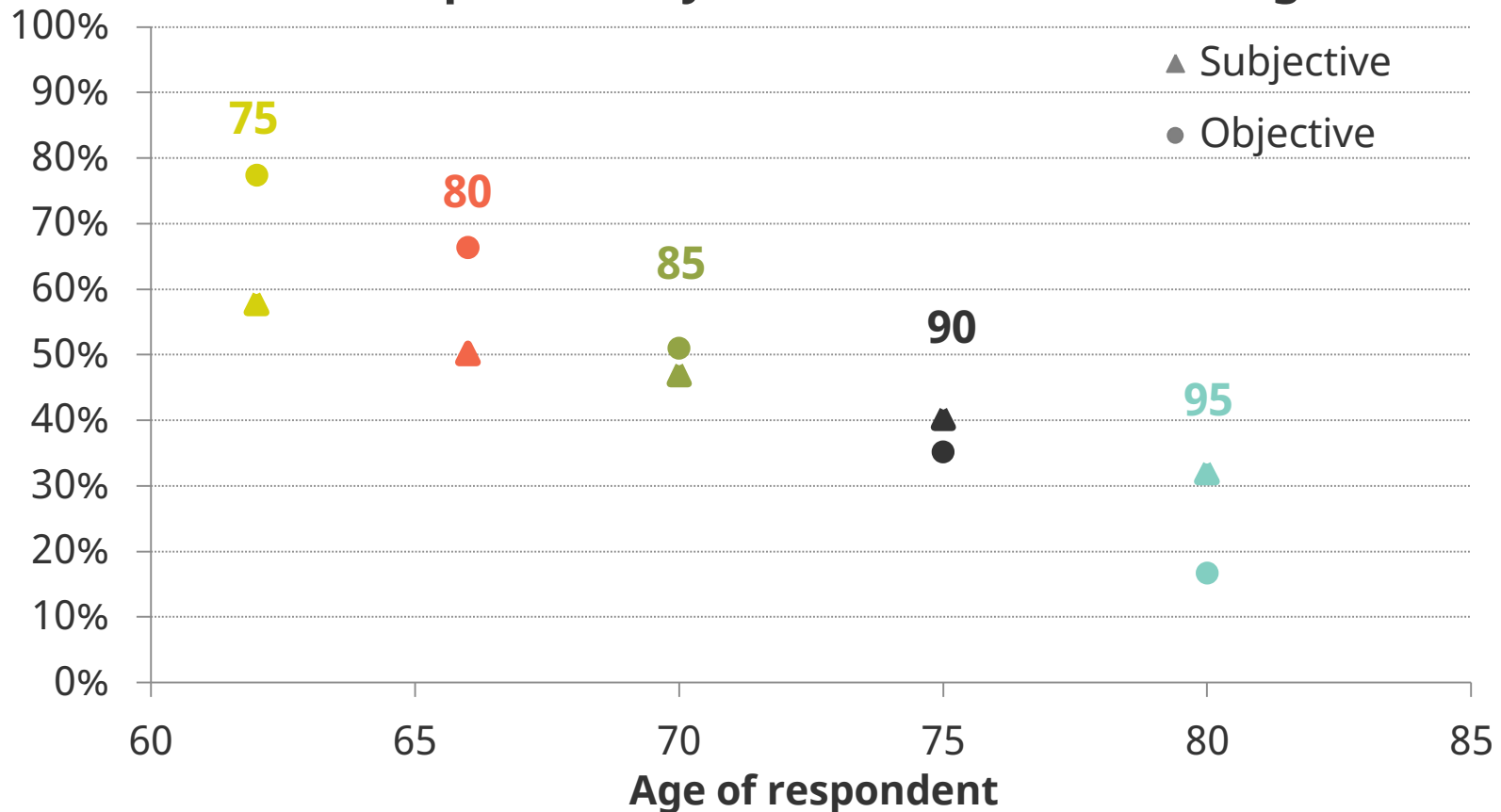
Uncertainty about mortality: survival pessimism

Do people have a good idea of how long they are going to live?

- How can we test this?

Uncertainty about mortality: survival pessimism

Mean probability of survival to at least age...



Uncertainty about mortality: survival pessimism

Do people have a good idea of how long they are going to live?

- How can we test this?

Pessimism about survival up to 85/90 and optimism for oldest ages

- Might people spend down their wealth too fast? (slow at oldest ages!)

What does this all mean for policy?

- Until 2015, essentially compulsory to use DC pension wealth to buy a guaranteed income, or “annuity”.
- 2015 “Pensions freedoms” gave consumers much more choice about use of wealth at retirement.
- Demand for annuities has fallen sharply (Cannon et al., 2016).

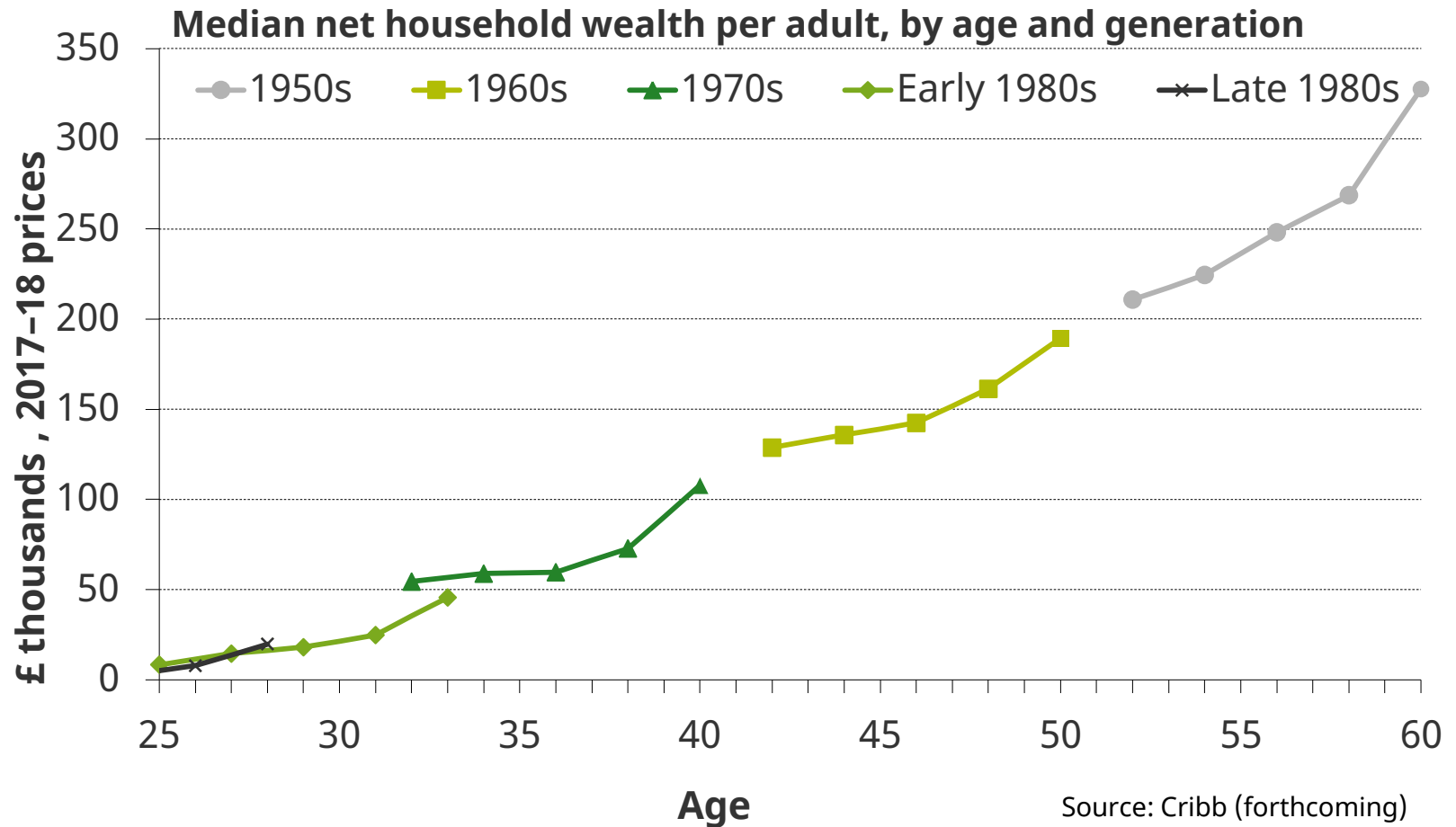
Should we be worried?

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- Only a minority saw significant falls in income at retirement

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Wealth accumulation has stalled for younger generations

- Are young people 'under saving'? Too much avocado toast?

But these generations saved in very different circumstances

- Reasons to save less: lower returns on savings, lower earnings growth
- Reasons to save more: live longer, less generous state pensions

It's not all about savings: people might choose to work longer too

Demographic change presents challenges

- Rising dependency ratio poses problems for sustainability of state pensions and defined benefit schemes
- The government is reacting by increasing the state pension age and firms increasingly offer defined contribution pension schemes
- Providing for retirement is increasingly the responsibility of individuals

Greater reliance on individual provision has its own challenges

- Accumulation: procrastination tackled with automatic enrolment?
- Decumulation: survival pessimism raises questions

Important to monitor how younger generations are saving

- Must be considered alongside wider economic circumstances

Further links

The adequacy of wealth amongst those approaching retirement (IFS)

<https://www.ifs.org.uk/comms/r72.pdf>

Economic circumstances of different generations (IFS):

<https://www.ifs.org.uk/uploads/publications/bns/bn187.pdf>

TED talk on “Save more tomorrow” (Shlomo Benartzi)

https://www.ted.com/talks/shlomo_benartzi_saving_more_tomorrow

Finkelstein, A. and Poterba, J., Adverse Selection in Insurance Markets: Policyholder Evidence from the U.K. Annuity Market. Journal of Political Economy

Benartzi, S. and Thaler, R., 2007. Heuristics and biases in retirement savings behavior. Journal of Economic perspectives

Thaler, R.H. and Benartzi, S., 2004. Save more tomorrow™: Using behavioral economics to increase employee saving. Journal of political Economy

Cribb, J. and Emmerson, C., 2016. What happens when employers are obliged to nudge? Automatic enrolment and pension saving in the UK. IFS Working Paper

O’Dea, C. and Sturrock, D., 2017. Subjective expectations of survival and economic behaviour. IFS Working Paper